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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

**COMMENTS OF
UNION PACIFIC CORPORATION
AND UNION PACIFIC RAILROAD COMPANY**

Union Pacific Corporation and Union Pacific Railroad Company (collectively, "UP") offer these comments in response to the Board's request for views on "major rail consolidations and the present and future structure of the North American railroad industry." Ex Parte No. 582, Public Views on Major Rail Consolidations, Decision served Jan. 24, 2000, p. 2.

INTRODUCTION

UP applauds the Board's decision to undertake a fundamental re-evaluation of major consolidations and the future structure of the railroad industry. Such a re-examination is necessary and urgent. The prospect of more major rail consolidations has already placed the railroad industry in harm's way. Railroad stocks have fallen sharply. Most carriers can no longer tap the equity markets for new capital. Even the largest railroads face the risk of hostile takeovers, possibly by parties with no interest in preserving the national rail system.[1]

[1] See Lawrence H. Kaufman, "Psst! You Want to Buy a Railroad? Cheap?," Journal of Commerce On-Line, Feb. 16, 2000 (Exhibit 1 hereto).

Of even greater concern, pressure for ruinous re-regulation is mounting in reaction to a recent merger proposal. Robert G. Szabo, Executive Director for Consumers United for Rail Equity, an organization seeking new rail regulation, said only a few days ago that "the [CN/BNSF] merger has thrust the issue onto the policy agenda" and "draws the attention of Congress."[2] If merely proposing a major merger increases the risk of re-regulation, approval of such a merger would only multiply the risk.

Meanwhile, debate over rail consolidations is diverting railroads from improving service at a time when all railroads should focus squarely on serving customers. The Board has many windows through which to view this diversion of resources: multiple visits by railroads to government offices; expensive campaigns to build shipper and political support; and the applicants' investment in a bevy of economists to represent it at this hearing. As a BNSF spokesman candidly admitted, "Our activity since Dec. 20 clearly has been focused on our combination with CN. Our energies have been put toward educating as many people as we can."[3] That energy should instead be put toward serving customers.

In his accompanying statement ("Davidson Statement"), UP Chairman and CEO Richard K. Davidson reviews UP's positions on the principal questions posed by the Board in this proceeding. UP believes that this is the worst possible time for major railroad consolidations. Shippers want railroads to devote their attention to improving service, not to more mergers, and proposing more large mergers exposes the railroads to debilitating re-

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2 National Journal, Feb. 26, 2000, p. 630 (Exhibit 2 hereto).

3 Id. at 631.

regulation. When UP investigated the possibility of a merger last fall, it concluded that proposing any large merger in today's environment would be irresponsible. UP calls on BNSF and CN to abandon their planned combination in order to restore stability to the rail industry.

SUMMARY OF UP'S COMMENTS

UP will not repeat Mr. Davidson's testimony here. Instead, in these comments, we propose modifications to the Board's outdated "General policy statement for merger or control of at least two Class I railroads," 49 C.F.R. § 1180.1. In a letter dated February 22, 2000, several members of the Senate Committee on Commerce, Science and Transportation encouraged the Board to consider comments in this proceeding in formulating "a more comprehensive rule on evaluating future mergers." If the Board commences a proceeding to consider any consolidation of Class I carriers, including the CN/BNSF consolidation, UP urges the Board to apply updated policies.

Traditionally, the ICC and the Board evaluated the effects of a consolidation by studying only reductions of competition in properly defined markets[4] and loss of essential services, harms it weighed against claimed public benefits. 49 C.F.R. § 1180.1(c). As recent public debate about the CN/BNSF proposal reveals, however, the most serious consequences of a Class I merger today lie beyond those factors. The Board should update its policy statement to reflect the changed circumstances of the railroad industry and the risks it now

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[4] Contrary to BNSF and CN assertions, their proposed combination would adversely affect competition in several important markets.

faces.[5]

UP asks the Board to modify its policy statement in the following ways:

First, the Board should update its outdated policy favoring mergers in order to rationalize rail facilities and eliminate excess capacity. Those goals have been fulfilled and the opposite problem -- inadequate capacity -- a major challenge facing the industry today. Board policy should instead favor capital investment.

Second, the Board should require applicants to address whether their consolidation (and resulting downstream consolidations) will result in regulatory changes and to identify the effects of those changes, particularly on railroad revenue adequacy and capital investment.

Third, the Board should require applicants to address with specificity all of the potential effects of their proposal on the quality of rail service.

Fourth, the Board should affirm its first decision in BNSF/CN that applicants must consider the "downstream effects" of their proposed transaction.

Fifth, the Board should clarify Section 1180.1(c) to require applicants to prove that any claimed public benefits could not be achieved through means short of merger, whether by individual carrier action, cooperative efforts among independent railroads, or

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[5] David T. Scheffman, professor of business strategy, marketing and economics at the Owen School of Management at Vanderbilt University and an expert on the economic issues related to mergers and acquisitions and related competition policy, has submitted a statement for UP explaining why the Board should broaden the array of factors it considers in its public interest balancing test. See Ex Parte No. 582, Statement of David T. Scheffman, Feb. 29, 2000 ("Scheffman Statement").

actions by third parties.

The Board should promptly notify prospective applicants -- including CN and BNSF -- that they will bear the burden of establishing in their application that their transaction is consistent with the public interest under the revised policy.[6] The Board has long required merger proponents to present a prima facie case sufficient to justify approval.[7] If applicants fail to shoulder this burden under the Board's revised policy, their application should be dismissed.

DISCUSSION

The Board's Class I railroad consolidation policy is obviously outdated. Some may recall that this policy derived from a special conference of interested parties very much like the present proceeding, conducted shortly before passage of the Staggers Act.[8] The railroad industry then bore little or no resemblance to today's railroads.

When the policy statement was adopted in the early 1980s, the railroads

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[6] See, e.g., Burlington N. Inc. -- Control & Merger -- St. Louis-San Francisco Ry., 360 I.C.C. 784, 1073 (1980) ("Applicants have the burden of showing that their proposed transaction is consistent with the public interest"); Norfolk S. Corp. -- Control -- North Am. Van Lines, Inc., 1 I.C.C. 2d 842, 858-860 (1985).

[7] See, e.g., Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R. -- Control -- Chicago & N. W. Holdings Corp. & Chicago & N. W. Transportation Co., 9 I.C.C. 2d 939, 950-51 (1993) (prima facie case for approval presented "because the evidence contained in the application, when construed most favorably to applicants (as required by the regulation), tends to show substantial public benefits, benign competitive impacts, and no adverse impacts upon carrier employees that the minimum mandated New York Dock conditions cannot cure"); 49 C.F.R. § 1180.4(c)(8).

[8] Notice of Special Conference on Railroad Merger Policy, June 17, 1980.

remained subject to constricting and detailed government regulation. Many railroads were in or emerging from bankruptcy proceedings, and the railroad that served the Northeast, Conrail, was under government control. The numerous Class I railroads were balkanized, and their inability to provide single-line service limited rate and service offerings. The railroads faced a serious problem of underutilized and unproductive assets.

None of the problems of the early 1980s remains today, except that the railroads still do not recover their full costs of capital. The railroads are financially healthier. Their rates have fallen sharply. They have improved their safety record. And they increased productivity by more than 70 percent. Through a succession of mergers in the 1980s and 1990s, the industry has consolidated to four large U.S. systems. Many of these mergers, such as UP/SP, were parallel mergers that eliminated redundant facilities and costs. As the Board has noted in several contexts, including in this proceeding, the railroads do not suffer from excess capacity today. They suffer from a capacity shortfall.

A. The Board Should Modernize Its Class I Merger Policy Statement

The Board should update its Class I merger guidelines to reflect the dramatic changes of the past 20 years. UP recommends the following changes.

1. Rationalization and Excess Capacity

The Board's policy statement is archaic and contrary to current national interests. It favors rationalization of rail facilities and reduction of excess capacity through consolidation when the rail industry needs more capacity, not less. It assumes that railroads can eliminate unneeded infrastructure by pursuing parallel mergers, when a parallel merger between the two large Class I carriers in either half of the U.S. would be virtually unthinkable. The Board should establish an updated policy that encourages capital investment, which is the foundation for quality rail service.

2. Regulatory Changes

The Board should require applicants to identify the effects of their proposed consolidation on the regulatory framework under which the rail industry operates, as well the effects of any changes in regulation. UP believes that a regulatory analysis is as important as the safety and environmental analyses that the Board already requires. Regulation crippled the industry prior to 1980, and any re-regulation that might result from major consolidations could set the industry on a course back toward that past.

A major merger proposal at this time will increase demands for re-regulation of the railroad industry. The Board has already heard from groups pressing for re-regulation as a result of the CN/BNSF proposal. Re-regulation advocates are meeting in Washington in March to increase the pressure for the type of "bottleneck" rate regulation that this Board rejected in 1998 and for forced access to solely-served shippers. The financial community's reaction to the CN/BNSF proposal confirms that another merger would increase the chances of re-regulation.[9]

Re-regulation would have devastating effects on the rail industry. As Mr. Davidson explains, re-regulation would deprive the railroads of revenue essential for

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[9] For example, Gary Yablon of Credit Suisse First Boston has opined that "the risk of further mergers and the potential for re-regulation issues hang over this industry like a black cloud and have severely depressed valuations." CSX: Reducing Earning Estimates, Feb. 11, 2000. See Appendix A for comments of other financial analysts of the effects of additional rail mergers at this time.

maintaining their infrastructure, forcing them to curtail a significant portion of the services they provide today. A UP study concluded that UP would lose some $750 million in net revenues. Professor Jerry Hausman, MacDonald Professor of Economics at MIT and a noted expert in the field of regulatory economics, is submitting in this proceeding a detailed explanation of the adverse consequences of re-regulation.[10] The Board cannot determine whether a proposed consolidation is in the public interest without considering these regulatory risks.

3. Effects on Service

Many other parties are likely to point out the importance of avoiding the service failures that followed recent mergers, notably but regrettably including the UP/SP merger. In future merger applications, applicants should be required to show how their proposal will affect service. BNSF and CN are already attempting to make this showing by minimizing BNSF's difficulties following its own merger.[11]

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[10] Ex Parte No. 582, Statement of Jerry Hausman, Feb. 29, 2000. Those consequences are also recognized by the financial community at large, see Appendix A; and indeed by BNSF's CEO in testimony before the Board in its 1996 bottleneck rate proceeding. See Krebs V.S. (Exhibit 3 hereto).

[11] Although far less severe than the service problems that followed the UP/SP merger, BNSF encountered service problems in implementing its merger. In 1998, BNSF's CEO, Robert T. Krebs, attributed BNSF service problems to the growing pains associated with the BN/Santa Fe merger, and stated that "[w]e have screwed it up." "Freight Shippers Critical of Rail Service," Portland Oregonian, Nov. 10, 1998, p. E1. Mr. Krebs also described the on-time performance that resulted from the BN/Santa Fe merger as "terrible." "Shippers Face Rough Ride on Rails," WWD, Feb. 24, 1998.

The Board should require applicants to show more than how they would avoid service failures during implementation of their merger. They also should evaluate the extent to which their proposal distracts management attention from service. Based on extensive experience with mergers and acquisitions in numerous industries, Professor Scheffman testifies that management distraction is virtually certain to arise from any major consolidation. Scheffman Statement, p. 8. That is already happening today, as the BNSF spokesman we quoted earlier (at page 2) admitted. In light of widespread shipper discontent with railroad service, the industry needs more than ever a sustained period of calm during which railroads can focus on improving service and working together to improve interline services. Another major merger would impede the industry's progress toward sustained service improvement.[12] Finally, applicants should address impacts of their operating plans on traffic flows over other carriers and consider any service problems that they may export to other railroads.

4. "Downstream Effects"

As the Board observed in its first decision in BNSF/CN, a CN/BNSF proposal, if approved, would be likely to lead to "another full round of major consolidations." See Finance Docket No. 33842, Decision No. 1A, served December 28, 1999. Professor Scheffman explains why strategic considerations would compel the remaining Class I railroads to react to any large merger, even if none of them believed that additional mergers

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[12] In addition, further consolidation of the six remaining major railroads could undermine cooperative efforts within the industry that offer significant promise of improving service and lowering costs. Davidson Statement, pp. 4-5.

were in the industry's interest. Unsure what other railroads will do, each carrier would feel pressure to select the most desirable partner before someone else does. Each would seek to maximize its negotiating leverage by moving first. Scheffman Statement, pp. 4-5. Mr. Davidson agrees with this view.

BNSF's Chairman, Robert T. Krebs, has all but announced his intent to merge with an eastern railroad if the CN/BNSF acquisition is approved.[13] Not surprisingly, the financial community also regards a subsequent round of mergers as the natural outgrowth of a CN/BNSF combination.[14] If a Class I combination were approved by the Board, that approval itself would encourage the remaining railroads to merge.

The Board should reaffirm, and include in its general policy statement, a requirement that merger applicants provide a realistic assessment of strategic responses to their consolidation. They should then evaluate the likely effects of any strategic responses on the public interest. If they do not expect other railroads to act in the manner they are proposing to act, they should explain why.

5. Merger-Specific Benefits

The Board should clarify its policy statement to require applicants to demonstrate that claimed merger benefits are likely to be achieved by consolidation but not

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[13] See BNSF 4Q99 Analyst Presentation, Remarks of Robert T. Krebs, Jan. 25, 2000 ("Sometime, if not today, or tomorrow, a year from now or two years from now somebody is going to say 'I want to do a trans-continental merger in the United States' . . . So it's going to happen. We are ready. CN is ready. . . . It seems to me if I was in the East and we pull this merger off we would be the number one preferred partner in the West.").

[14] See Appendix A.

otherwise. Such benefits are sometimes described as "merger-specific." Under its current policy statement, the Board will "consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public." 49 C.F.R. 1180.1(c). The ICC did not always apply this policy consistently, however, and the applicants' burden of proof was unclear.[15]

Applicants should be required to prove that the public benefits of the consolidation could not be achieved through less harmful alternatives to consolidations. Those alternatives would include interline cooperation, industry-wide initiatives, introduction of new technology, and the blossoming of e-business. Davidson Statement, pp. 4-5.

This approach reflects sound public policy for several reasons. First, as already noted, the public interest in rationalizing railroad infrastructure and eliminating excess capacity has evaporated, so there is no reason to bias the Board's analysis in favor of finding merger benefits. Second, cost-reduction programs at individual railroads, the streamlined structure of today's railroad industry, and rapid advances in technology all offer railroads new opportunities to achieve benefits traditionally attributed to end-to-end mergers. Mr. Davidson describes many of the initiatives that the industry and individual railroads are

[15] In the past, the Board and the ICC periodically rejected claims that benefits attributed to proposed mergers could be achieved through other means. Those decisions, however, were based on the Board's conclusion that the particular benefits advanced in those cases were in fact unlikely to be achieved absent a merger, rather than on a conclusion that benefits must always be credited regardless of the extent to which they could be achieved in other ways. CN/IC, Decision No. 37, served May 25, 1999, pp. 47-49; UP/SP, Decision No. 44, served Aug. 6, 1996, 1996, pp. 111-12; SFSP, 2 I.C.C.2d 709, 872 (1986); UP/MP/WP, 366 I.C.C. 462, 492-93 (1982).

pursuing today. Without consolidation, railroads can share best practices; they can enter into long-term alliances to coordinate their interline operations, marketing, and investment activities; they can develop and implement operational coordinations, such as joint dispatching centers and the ongoing unprecedented effort to streamline Chicago terminal operations; and they can develop business and operational processes (such as the Interline Service Management program) to facilitate interline operations and provide information previously available only for single-line movements. Davidson Statement p. 4.[16] Third, requiring applicants to demonstrate that benefits can be achieved only by merger is consistent with the analysis employed by most federal agencies.[17]

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[16] Notably, CN and BNSF are already working to develop and implement "a range of mutually beneficial interline coordinations," including "matters relating to information technology (intended to develop a common information technology platform), procurement and marketing." CN-BNSF Combination Agreement, Dec. 18, 1999, § 5.13. (Exhibit 4 hereto) These improvements do not require a CN/BNSF consolidation.

[17] This is the approach of the U.S. antitrust enforcement agencies and courts, see, e.g., DOJ & FTC 1992 Merger Guidelines, Sec. 4 (with Apr. 8, 1997, revisions) ("The Agency will consider only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed *merger-specific efficiencies*."); United States v. Rockford Memorial Corp., 717 F. Supp. 1251, 1289 (N.D. Ill. 1989) ("Efficiencies benefitting the merged entity, but obtainable by means independent of merger are not relevant for § 7 purposes."), aff'd, 898 F.2d 1278 (7th Cir.), cert. denied, 498 U.S. 920 (1990).

The Canadian Competition Bureau, which will be reviewing the competitive effects of the proposed CN/BNSF transaction in Canada, likewise considers "only efficiencies that directly arise from merger and could not be achieved without merger." Canada Competition Bureau, Merger Review Under the Competition Act, Feb. 2000 (Exhibit 5 hereto).

Other regulatory agencies reviewing mergers do not recognize benefits that could be achieved in other ways. See, e.g., Money Station, Inc. v. Board of Governors of the Federal Reserve System, 81 F.3d 1128 (D.C. Cir. 1996), reh'g granted & vacated upon grant reh'g, Commissioner Tantrum's concurring statement in CSX-Control-Chessie & Seaboard, written when the industry was on the brink of de-regulation and the then-unknown innovations that such a world would bring, is equally applicable today:

> It should be incumbent upon future merger applicants to bear the burden of demonstrating that the benefits they attribute to a proposed merger will be greater than the benefits which would result from cooperative endeavors between their separate firms. Railroads must be encouraged to acquaint themselves with and test innovative and competitive practices as an alternative to a less imaginative merger response. Railroads can realistically capture substantial benefits through fresh business opportunities created by deregulation.[18]

Recent statements and submissions by CN and BNSF underscore the importance of probing merger benefit claims. CN has made numerous public claims about the benefits of its CN/IC merger that appear to be either premature or unwarranted. BNSF's recent descriptions of its 1995 merger are exaggerated and conflict with prior BNSF assertions citing other causes.

CN officials have stated recently that "the merger of CN and IC has been accomplished without a single hiccup."[19] It appears, however, that the merger has not yet

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94 F.3d 658 (199_) (appeal subsequently dismissed by stipulation); In the Application of Ameritech Corp. & SBC Communications Inc., 14 F.C.C.R. 14712, 14829-30 (1999); Bergt-AIA-Western-Wien Acquisition/ Control Case, 96 C.A.B. 253, 280 (1982).

[18] CSX Corp. -- Control -- Chessie System, Inc. & Seaboard Coast Line Industries, Inc., 363 I.C.C. 521, 600 (1980).

[19] James M. Foote, CN Senior VP Sales & Marketing, Letter to Traffic World, Feb. 14, 2000, p. 8 (emphasis added) (Exhibit 6 hereto); see also CN Press Release, Jan. 26, 2000 (quoting CN President Paul Tellier as saying that, during 1999, "we integrated IC flawlessly.").

been implemented to any significant degree. For example, CN describes the integration of CN and IC information technology systems as "[o]ne of the most significant steps the new railroad can take to realize the full benefit of the merger" and the "key to a successful merger."[20] Yet this process, which caused service disruptions on BNSF, UP/SP, NS and CSX after recent mergers, will not even begin for several months. The "IT" integration is scheduled for the fall.[21] Similarly, although CN and IC forecast that their merger would divert $165 million of traffic annually from UP,[22] UP has been unable to identify a single carload of traffic lost due to the CN/IC merger. Davidson Statement, p. 5.

The operating improvements recently cited by CN do not appear to result from this merger. CN describes extensive sharing of "best practices" under the direction of Hunter Harrison, but CN hired Mr. Harrison from IC in March 1998, more than a year before the CN/IC merger. Rather than showing benefits of a merger, Mr. Harrison's move to CN demonstrates a way railroads can obtain benefits without a consolidation. CN's transit time improvements between Chicago and the Mexican border[23] result at least in substantial part from CN's "Alliance" with KCS, developed more than a year before the CN/IC merger.

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[20] CN/IC Web Site, Feb. 20, 2000: www.cn.ca/cnwebsite/cnwebsite.nsf/public/ en_MergerIntegrationofCNandICFAQ (Exhibit 7 hereto); www.cn.ca/cnwebsite/ cnwebsite.nsf /public/ en_MergerComputerSystemIntegration (Exhibit 8 hereto).

[21] CN/IC Web Site, Feb. 20, 2000: www.cn.ca/cnwebsite/cnwebsite.nsf /public/ en_MergerComputerSystemIntegration (Exhibit 8 hereto).

[22] CN/IC, CN/IC-7, July 1998, Woodward & Rogers V.S., p. 11.

[23] See CN/IC Web Site, Feb. 20, 2000: www.cn.ca/cnwebsite/cnwebsite.nsf/ public/en_MergerDeliveringonthemergerpromise (Exhibit 9 hereto).

Similarly, all of CN's service improvement trends pre-dated the merger.[24] CN should be proud of recent operating gains. But it is highly improbable that ongoing operating improvements spanning the entire CN system are attributable to the modest CN/IC merger, which does not affect most CN service lanes.

BNSF recently has made extravagant claims about the benefits of its 1995 BN/Santa Fe merger, both in a recent submission to the Board and in public presentations. BNSF attributes to the BN/Santa Fe merger the "lion's share of our improvements" in "every category of safety, business growth, customer service, transportation, value, efficiencies, employment security financial performance, expanded capacity and investment in equipment and facilities." UP/SP, The Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report BNSF-PR-14, Jan. 18, 2000, pp. 15-16.[25] Even a superficial review of BNSF's UP/SP presentation reveals that many of the improvements BNSF now attributes to its merger are unrelated to it or would have occurred anyway.

For example:

- BNSF safety improvements, measured by grade crossing incidents and employee injuries, reflect industry-wide trends that cannot be attributed to this or any other merger.[26]

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[24] See, e.g., Mark Hallman, CN System Director Media Relations, Letter to Traffic World, July 5, 1999 (describing the "full picture" of CN's service performance, including significant pre-merger improvements in on-time performance and reductions in transit times and terminal dwell times) (Exhibit 10 hereto).

[25] BNSF does acknowledge that, "[a]dmittedly, not all of the improvements are directly attributable to the merger." Id., p. 15.

[26] Charts 1 and 2 below show the relationship between BNSF's performance and that of other Class 1 railroads in several of the "safety" parameters BNSF has chosen to highlight.

- BNSF attributes improvements in on-time performance and other key service measures to its merger, but the only data BNSF provides that cover both the pre-merger and post-merger periods suggest that implementation of the merger had a negative impact on BNSF's performance.[27] As noted earlier, Mr. Krebs described BNSF's intermodal service during that period as "terrible" (WWD, Feb. 24, 1998). Santa Fe service was at record levels before the merger caused it to deteriorate.[28]

- Although BNSF now attributes significant post-1997 service improvements to its merger, it has publicly attributed those same improvements to other causes, such as the implementation with UP of joint dispatching centers and billions of dollars of new investment in its Chicago-Los Angeles mainline.[29]

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[27] See note Chart 3, which is based on BNSF, Chart No. 16. BNSF's submission in UP/SP acknowledge that "service slipped in the pre-1998 period," i.e., for more than two years following the merger. UP/SP, BNSF-PR-14, Jan. 18, 2000, p. 14.

[28] *On Time Performance Hits Record at Santa Fe*, May 8, 1995 (Exhibit 11 hereto).

[29] When BNSF announced the establishment of joint dispatching centers covering the Los Angeles and Kansas City terminals and the Powder River Basin joint line, it described "improved cooperation and communication in the dispatching process" as "keys to enhancing the level of service our customers expect," it stated that the joint Houston-area dispatching center (in Spring, Texas) established during 1997 had been a "success" by "almost any measure.

> For example, blocked sidings between Houston and New Orleans were reduced from a daily average of six to zero within the first 60 days of the center's opening, leading to increased velocity and improved schedule adherence. Trains going 'dead on the law,' meaning those whose crews have reached the maximum number of continuous hours worked under the federal Hours of Service Act and, therefore, must stop until the crews are relieved, have been drastically reduced from a high of 64 per month in May of 1998 to a total of 15 in January 1999, further signaling an improvement in velocity.

- BNSF's revenue growth in the two years following implementation of its merger, which began in September 1995, not only lagged behind the projections of merger benefits in the BN/Santa Fe application, but lagged behind the growth rate achieved by the other Class I railroads during the same period.[30] Moreover, much of BNSF's revenue growth since its merger resulted from the new rights BNSF received in the UP/SP merger, including much-improved access to Mexican gateways, and from UP's service difficulties.

- The routes on which BNSF says it achieved substantial intermodal, coal and other traffic growth as a result of its merger -- including the former Santa Fe route between Chicago and California, the former BN route between Chicago and the Pacific Northwest and the former BN coal routes from the Powder River Basin to Washington and Michigan -- were single-line routes before the merger. These traffic flows were not affected by the merger.[31]

- Most of BNSF's "top capital investments"[32] between 1994 and 1999 were not merger related. Many were planned or underway prior to the BN/Santa Fe merger or, like the investments in trackage rights and other line acquisitions resulting from the UP/SP merger and BNSF's Stampede Pass reactivation, had nothing to do with the merger. Of the "top" projects, only a small expansion of the previously completed facility "Alliance" project was identified in the BN/Santa Fe merger application as related to the merger. BN/Santa Fe, BN/SF-8, Operating Plan, Oct. 1994, pp. 93, 95.[33]

BNSF News Release, Feb. 8, 1999 (Exhibit 12 hereto).

30 Set forth as Chart 4 below is a revised version of BNSF's "Chart No. 12" that includes columns showing the level of revenues BNSF would have achieved in 1996 and 1997 had it kept pace with the rate of growth of other Class 1 carriers.

31 See, UP/SP, The Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report, BNSF-PR-14, BNSF charts 15 and 19.

32 Id., chart 59.

33 For example, William Springs was commenced in 1992, and the Alliance intermodal facility opened in April 1994, and the Argentine Yard configuration was begun early in 1995.

- The most significant new single-line route achieved by the BN/Santa Fe merger was the so-called Avard gateway route between Los Angeles and Memphis. Although BNSF realized traffic growth on that route following the merger, it is uncertain to what extent similar growth would have been achieved through cooperative efforts. Although some prior cooperative efforts had not been successful, within the year preceding their merger announcement, BN and Santa Fe had implemented an innovative "joint-line venture" involving Santa Fe haulage rights between Avard and Memphis that, according to BN/Santa Fe's own witnesses, had begun to achieve "increased intermodal volumes over the lane." BN/Santa Fe, BN/SF-7, Cane V.S., Oct. 1994, p. 25.

When scrutinized closely, the claims of significant benefits from these recent end-to-end mergers erode. Many of the benefits were not dependent on a merger and were, or likely could have been, achieved through other means. The Board should be appropriately skeptical of arguments that an end-to-end merger is needed in order to obtain predicted benefits.

B. The Board Has Ample Authority to Revise Its Merger Policy Statement

The Board has authority under existing law to adapt its analysis of the public interest in rail merger proceedings to changing circumstances. Congress directed the Board to consider a wide array of potential issues when it evaluates whether merger proposals are consistent with the public interest. Congress explicitly demanded that the Board consider "at least . . . the effect of the proposed transaction on the adequacy of transportation to the public." 49 U.S.C. § 11324(b)(1).

The Supreme Court repeatedly held that the Interstate Commerce Act gave the ICC very wide latitude to determine what "factors [are] relevant to the public interest" and to consider the full array of potential consequences -- both short-term and long-term -- of a proposed consolidation. Penn Central Merger & N&W Inclusion Cases, 389 U.S. 486, 498-99 (1968); see also, e.g., Gilbertville Trucking Co. v. United States, 371 U.S. 115, 127-29 (1962); McLean Trucking Co. v. United States, 321 U.S. 67, 85-86 (1944); United States v. Lowden, 308 U.S. 225, 230-31, 238 (1939).[34] Indeed, Congress entrusted the Board with the task of concluding that any proposed rail merger would "serve the national interest and that terms are prescribed so that the congressional objective of a rail system serving the public more effectively and efficiently will be carried out." Penn Central, 389 U.S. at 500 (1968).[35]

Key aspects of the national rail transportation policy, which shape the contours of the public interest, likewise call for an updated policy statement. See New York Central Securities Corp. v. United States, 287 U.S. 12, 24-25 (1932), At least the following components of the rail transportation policy apply: "promot[ing] a safe and efficient rail transportation system, by allowing rail carriers to earn adequate revenues," 49 U.S.C. § 10101(3); "ensur[ing] the development and continuation of a sound transportation system . . . to meet the needs of the public and the national defense," 49 U.S.C. § 10101(4); "foster[ing] sound economic conditions in transportation;" 49 U.S.C. § 10101(5); and ultimately, "minimiz[ing] the need for Federal regulatory control over the rail transportation system." 49 U.S.C. § 10101(2) Thus, the Board should consider merger effects that would lead toward

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[34] See also, e.g., Norfolk S. Corp. -- Control -- North Am. Van Lines, Inc., 1 I.C.C. 2d 842, 859 (1985) (emphasizing need to "weigh[ ] elements of the public interest and evaluat[e] both the potential short- and long-term impacts of the consolidation")

[35] This obligation exists notwithstanding Congress' original policy, set forth in the Transportation Act of 1940, to "consolidate the railroads of this Nation into a 'limited number of systems.'" Id. It seems obvious that this goal has been realized.

greater federal regulation.

Thus it is clearly appropriate for the Board to adapt its public interest analysis as circumstances change. In the industry's current circumstances, a major rail consolidation likely will have adverse consequences that transcend the considerations on which the Board's recent merger cases have focused. Protection of the public interest demands that all potential consequences be explored and that applicants prove that a transaction they propose is in the public interest notwithstanding those consequences.

CONCLUSION

UP believes that any merger between Class I railroads at this time would be ill-considered and contrary to the public interest. The CN/BNSF proposal has already destabilized the railroad industry and increased the risk of crippling re-regulation. Approval of this or any other merger would worsen an already dangerous situation. We urge BNSF and CN to recognize these risks, set aside their private interests, and wisely terminate their plans to consolidate.

Because of the prospect that BNSF and CN will persevere in their quest to consolidate, UP respectfully asks the Board to issue an order no later than March 17, 2000 revising the Board's "General policy statement for merger or control of at least two Class I railroads," 49 C.F.R. § 1180.1. We suggest that the Board eliminate the opening sentences of Section 1180.1(a) as having been fully satisfied and replace it with a policy recognizing the need for capital investment. In addition, the Board should require applicants to consider at least the following additional factors:

- The likelihood that the proposed transaction will result in changes in the regulatory framework applicable to rail carriers and the effects of those changes.
- The likelihood that the proposed transaction will adversely affect service that would otherwise be offered by the applicants or other carriers, whether as a result of diversion of resources from service, loss of cooperation among carriers, or implementation of the transaction.
- The likelihood that the proposed transaction will prompt additional transactions and the effects of those transactions on all public interest considerations.

We also ask the Board to clarify its policy to "consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation." 49 C.F.R. § 1180.1(c). The Board should clarify that it will consider as public benefits only those merger-specific benefits that could not realistically be achieved by the applicants as separate companies or in cooperation with others.

Respectfully submitted,

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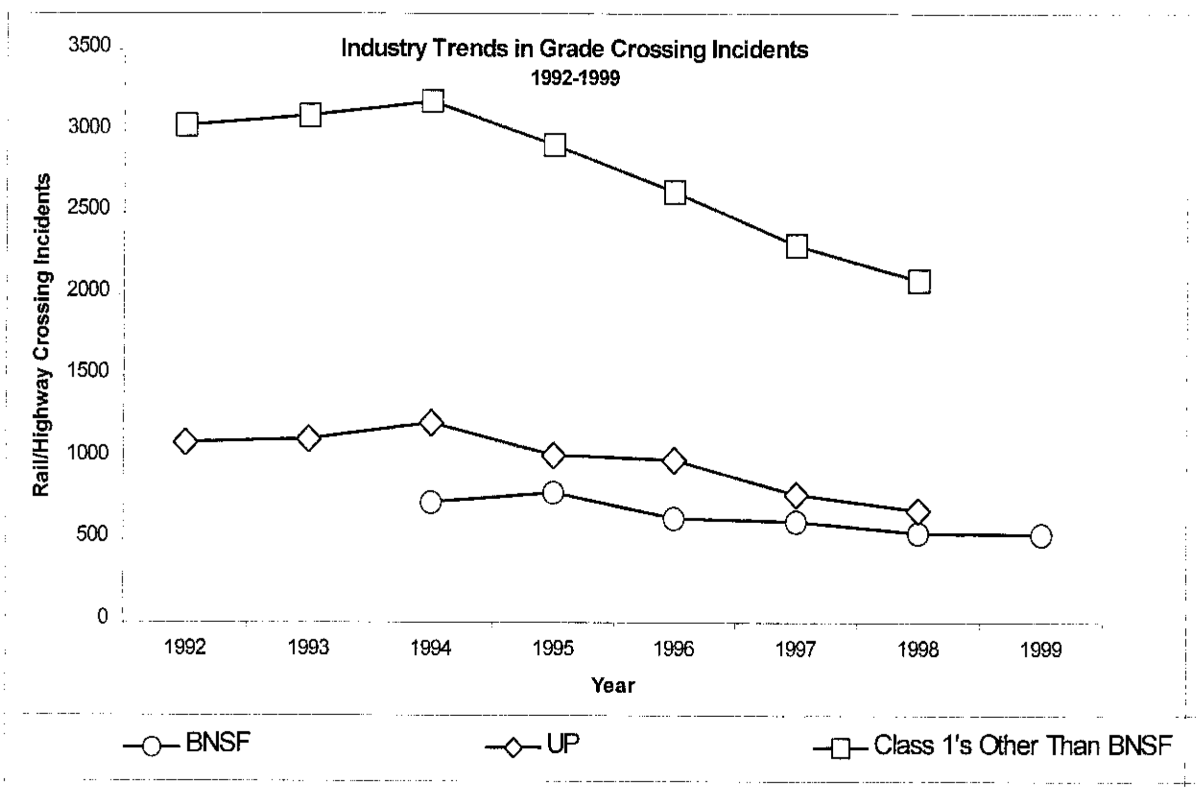
February 29, 2000

CHART 1

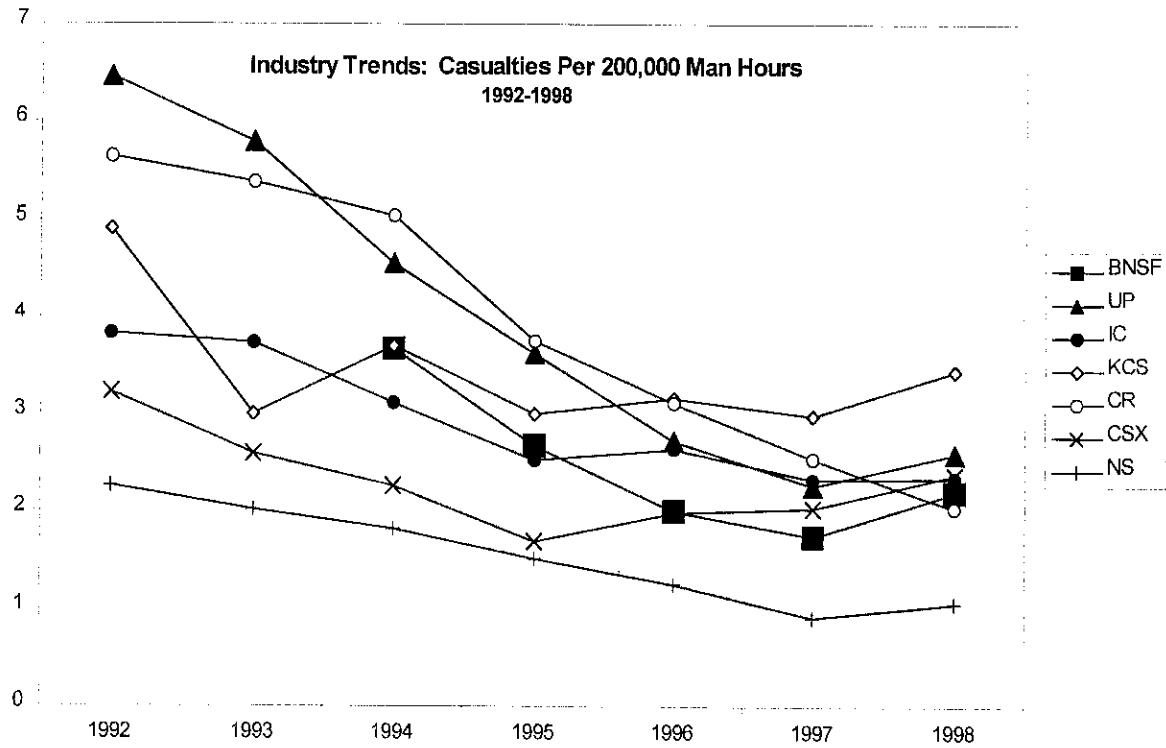
BNSF Grade Crossing Incident Experience Reflects Industry Trends



Source: UP/SP, BNSF-PR-14, Jan. 18, 2000, Chart No. 8, p. 25; FRA Reports.

CHART 2

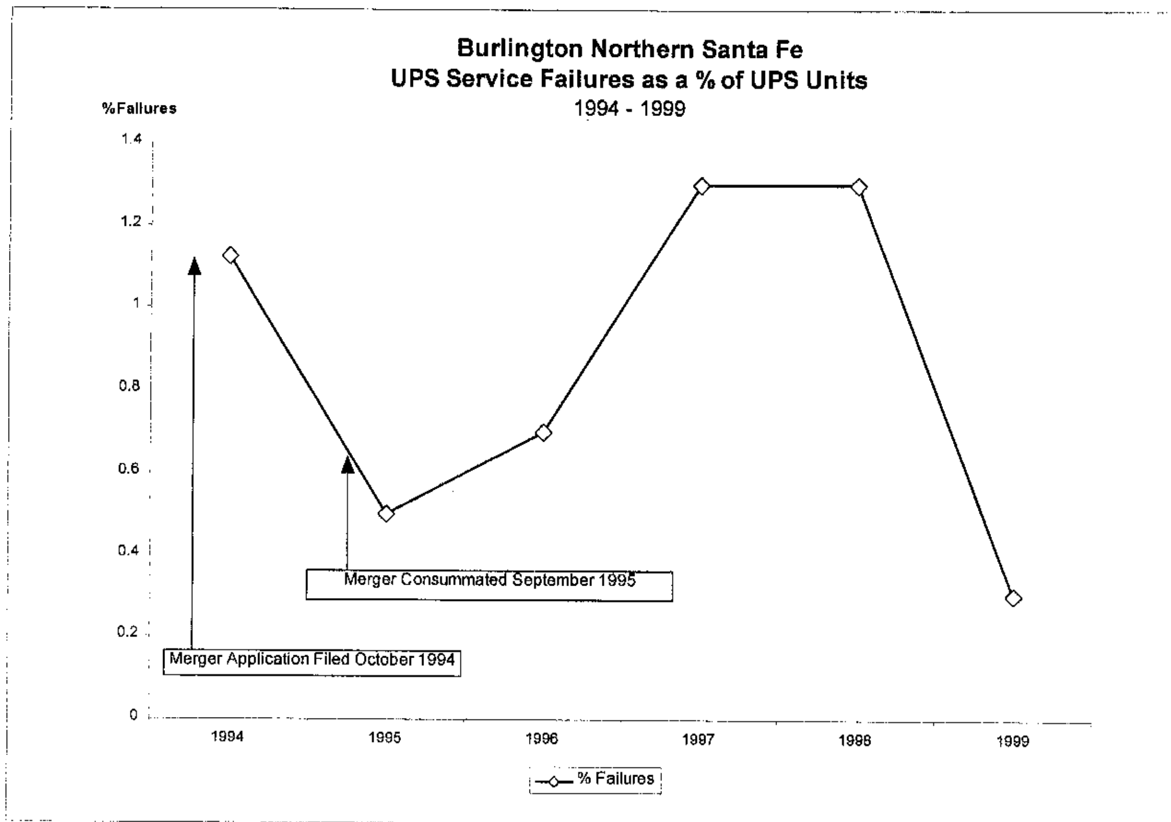
BNSF Casualty Experience Reflects Industry Trends



Source: UP/SP, BNSF-PR-14, Jan. 18, 2000, Chart No. 1, p.18; AAR Frequency Reports of Employee On Duty Fatalities and Reportable Injuries and Occupational Illnesses.

CHART 3

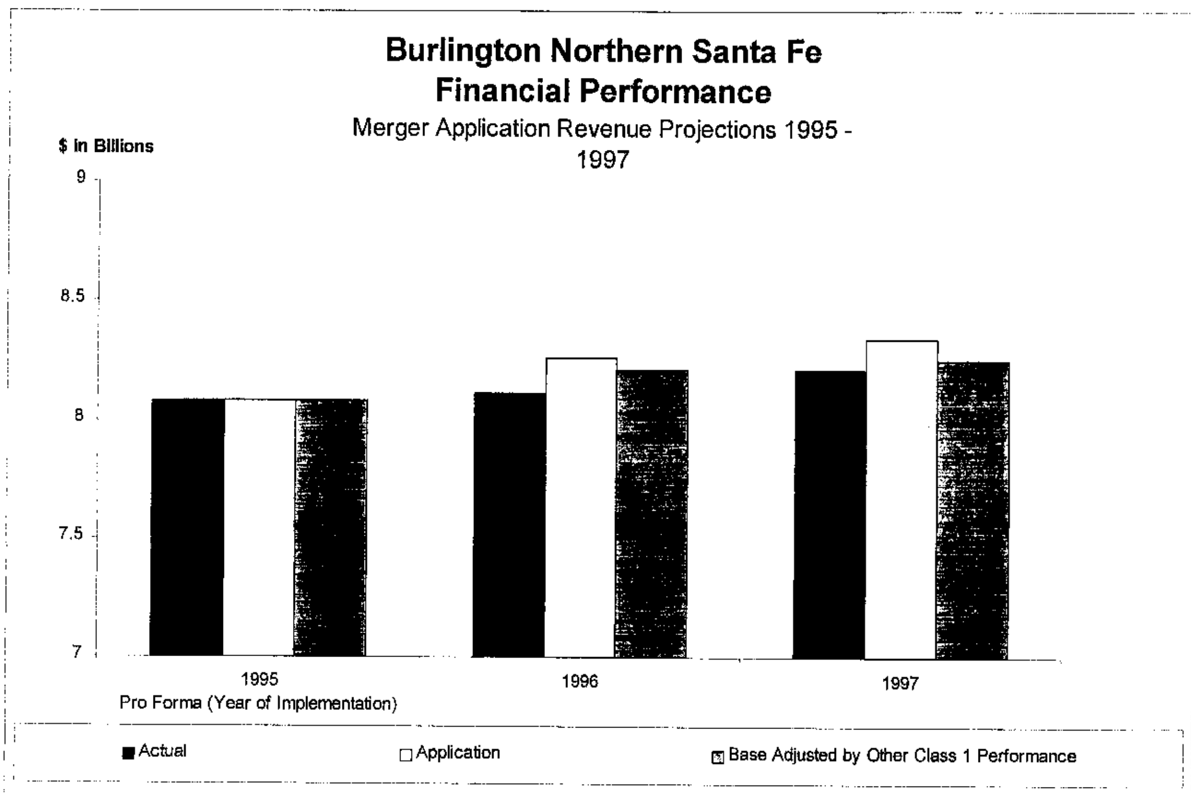
Implementation of BN/Santa Fe Merger Had Questionable Impact on BNSF Service



Source: <u>UP/SP</u>, BNSF-PR-14, Jan. 18, 2000, Chart No. 16, p. 36.

CHART 4

BNSF Revenue Following BN/Santa Fe Merger
Lagged Application Forecasts and Other Class 1 Railroads



Source: UP/SP, BNSF-PR-14, Jan. 18, 2000, Chart No. 12, p. 32.; Class 1 R-1 data.

APPENDIX A

PUBLISHED VIEWS OF THE FINANCIAL COMMUNITY

Since the December 20, 1999, announcement of the proposed CN/BNSF combination, the financial analyst community that follows the railroad industry has reached a broad consensus that:

- **A FURTHER MAJOR RAIL CONSOLIDATION AT THIS TIME IS DISTRACTING AND DESTABILIZING:**

  "We believe investors were truly shocked with the Canadian National merger announcement and are unclear why Burlington Northern is deviating from a plan that was just starting to get on the right path."
  Gary Yablon, Credit Suisse First Boston, BNI: Weakness in Stock Overdone. Catalysts Coming. Buy Now. (Jan. 6, 2000).

  "We . . . continue to find the timing of the combination puzzling, and have yet to hear a justification for that timing that makes sense in light of the uncertainty it creates."
  James M. Higgins, DLJ Securities, Tracking the Rails 23: Reversal of Fortune or Dead Cat Bounce? (Jan. 18, 2000).

  "[I]t may be premature to kick off the next round of industry consolidation when tension between rail customers and the railroads is so high."
  James J. Valentine, Morgan Stanley, First Salvo Fired in BNI-CNI Merger Proceeding (Jan. 11, 2000).

- **THE CN/BNSF PROPOSAL CREATES A HEIGHTENED RISK THAT CONGRESS WILL RE-REGULATE THE INDUSTRY:**

  "Concern that the December 20 BNI/CNI merger announcement will beget yet another round of industry consolidation, and eventually result in only two North American transcontinental railroad systems, appears to have stoked the political fires in Washington."
  James M. Higgins, DLJ Securities, STB Plans March 8 Public Forum on the Effects of Consolidation in the Rail Industry; More Pressure on BNI and CNI (Jan. 25, 2000).

  "Had we not had the BNI/CNI announcement, the entire topic [of the STB reauthorization] might have been shelved and the current regulatory status quo would prevail. But we think this scenario is now unlikely, as we expect

customer opposition groups to lobby the halls of Congress over concerns that the BNI/CNI merger will put more power in the hands of fewer railroads. Such efforts may result in a modified STB bill that would include a shift in economics from the railroads to the customers or could eliminate the STB altogether by shifting railroad merger authority over to the Department of Justice . . . ."
James J. Valentine, Morgan Stanley, Railroads: BNI/CNI Muddying the Regulatory Waters (Dec. 27, 1999).

"While this [additional round of rail mergers] might seem like the end of the story, we should caution that the proposal alone would create a huge uproar by the shippers, potentially leading to massive industry re-regulation even before either merger could make it to the end of the STB's review process. The uncertainty could create unwanted risk for the railroads and we could see their valuation multiples contract even further."
James J. Valentine, Morgan Stanley, CSX Corp: Make Room at the Merger Altar (Jan. 28, 2000).

"We have already heard from a number of shipper related camps of the open access threat. . . . While we do not expect this type of legislation in the rail industry the scenario of more mergers does move the sentiment in Washington more in that direction, in our opinion."
Gary Yablon, Credit Suisse First Boston, Railroad Industry: STB Hearings in March Key to Stock Performance (Feb. 9, 2000).

"We furthermore believe that Burlington's and Canadian National's argument that the end-to-end nature of their proposed merger makes them essentially impervious to regulatory risk is myopic: While their merger might fit the letter of the current law, the real risk is that the laws change. This is more than anything becoming a political issue . . . ."
James M. Higgins, DLJ Securities, CN: Noise Level Likely to Be High and Distracting; Reducing Rating to Market Performance (Dec. 21, 1999).

"Rumblings of dissatisfaction from Congress have begun cropping up."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

- **THE INCREASED RISK OF FURTHER CONSOLIDATION OR RE-REGULATION STEMMING FROM THE CN/BNSF PROPOSAL HAS DISCOURAGED INVESTMENT IN THE INDUSTRY:**

"The industry as a whole has come under a cloud, as investors have questioned the nature of competitive responses from and damage to other carriers from a BNI/CNI combination."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

"If we believed that the regulatory risks that have been stirred up by the BNI/CNI announcement will cast a lingering shadow over the entire railroad industry, we'd have little interest in any of the stocks."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

"Confusion and uncertainty about regulatory and political risk on heels of BNI/CNI merger announcement will limit new money flows into all rail equities."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

"[T]he risk of further mergers and the potential for re-regulation issues hang over this industry like a black cloud and have severely depressed valuations."
Gary Yablon, Credit Suisse First Boston, CSX: Reducing Earnings Estimates (Feb. 11, 2000).

"Regulatory risk is real, as the STB has been funded only through September, 2000, and it needs to be reauthorized by Congress at some point. Early signs from shippers are that many are eager to use their dissatisfaction with this latest proposed step in railroad industry consolidation as a lever to threaten changes to the STB's charter — or eliminate the Board altogether — that would change the merger review guidelines and, potentially, threaten the economics of the entire industry."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

"Investors are very tired of the sort of uncertainty that yet another railroad mega-merger perpetuates, and the regulatory and political risks related to the timing of the BNI/CNI announcement embody, in our opinion, the crux of that risk."
James M. Higgins, DLJ Securities, Tracking the Rails 22: Deja Vu All Over Again (Jan. 5, 2000).

"[U]ntil this [proposed CN/BNSF transaction] is resolved many clouds from the investor point of view will remain, even at these severely depressed valuation levels."
Gary Yablon, Credit Suisse First Boston, CSX: Further Thoughts on 4Q:99 (Jan. 31, 2000).

"Clearly the railroad industry stocks are discounting significant fear of further consolidation and re-regulation that would impair financial returns. . . . All in all, given the large clouds that remain over the stocks with respect to merger-mania (and what may be competitive responses to the BNI-CNI announcement) we are using VDF work to order the group and nothing more."
Gary Yablon, Credit Suisse First Boston, Railroad Industry: VDF Work Shows Stocks Attractive (Feb. 1, 2000).

"[W]ith the recent announcement of an intended merger between Burlington Northern Santa Fe and Canadian National, investors fear the repercussions of future mergers to earnings, free cash flows and financial returns. Shipper outcries against further mergers over the intermediate-term, due to the service disruptions that these mergers have brought, also stoke the fears of the potential for re-regulation of the industry. Hence, while on the surface traditional valuation work shows the stocks to be attractive, clearly there are reasons for these depressed multiples."
Gary Yablon, Credit Suisse First Boston, Railroad Industry: VDF Work Shows Stocks Attractive (Feb. 1, 2000).

"This [near-term cloud of uncertainty for the group] is one more reason we would be cautious about owning any North American railroads at this time."
James J. Valentine, Morgan Stanley, Railroads: BNI/CNI Muddying the Regulatory Waters (Dec. 27, 1999).

- **THE TRANSACTION MAY SPAWN FURTHER CONSOLIDATION IN THE INDUSTRY, WITH EVEN MORE SERIOUS DOWNSTREAM EFFECTS:**

"CSX's Chairman John Snow basically said that if this deal does go through it is likely that other mergers will follow. Indeed, if we look back over the past thirty years or so we cannot find an instance where a large merger occurs in isolation."
Gary Yablon, *Credit Suisse First Boston, CSX: Further Thoughts on 4Q99 (Jan. 31, 2000).*

"If the BNI/CNI merger review process is not stopped by this summer, it will most likely lead to announcements by the other industry players to merge down to 2 North

American railroads. This could incite new, far-reaching and unwanted industry regulations."
James J. Valentine, Morgan Stanley, CSX Corp.: Make Room at the Merger Altar (Jan. 28, 2000) 1/28/00.

"We find [BNSF's suggestion that combining with CN may not trigger further consolidation] puzzling in light of discussion about how powerful the combined BNI/CNI would be. In other words, does Burlington management really expect their competitors not to try to optimize their networks as the competitors' competitor (*i.e.*, BNI/CNI) gets stronger? We don't think so."
James M. Higgins, DLJ Securities, BNSF: Quarter In Line With —Slightly Above — Consensus Expectations, But It Probably Doesn't Matter; Rationale for Timing of Merger Announcement Remains a Mystery; Continue Market Performance Rating (Jan. 25, 2000). 1/25/00.

"It is clear from statements made by John Snow, CSX's Chairman and CEO, that he will not sit idly by and let BNI and CNI go down the aisle of matrimony alone. If BNI and CNI are allowed to submit their merger application in March/April and they receive shareholder approval, Snow intimated that it will lead to one massive and final round of industry consolidation including CSX. Snow is concerned about BNI and CNI getting a two-year jump on implementing a merger, and therefore will not wait until the end of the Surface Transportation Board (STB) BNI/CNI proceedings before making a strategic move."
James J. Valentine, Morgan Stanley, CN: Near-Term Uncertainty Keeps Us Neutral (Jan. 28, 2000).

"We've suspected this could occur, but Snow made it very clear that by this summer, if BNI/CNI are allowed to go ahead with their merger application process, he will be forced to marry up with another industry player to avoid the 'two-year lead' that BNI/CNI would have if their merger does get approved during the summer of 2001. In other words, if the BNI/CNI merger doesn't get outright rejected by the STB or shareholders by May or June, we can expect more big merger news to soon follow, with only 2 major players left standing."
James J. Valentine, Morgan Stanley, CSX Corp: Make Room at the Merger Altar (Jan. 28, 2000).

"[Once the CN/BNSF application is filed,] perhaps in April, Union Pacific may decide to actively pursue its own merger agenda. While a merger with one of the two large eastern rails may be considered, the timing seems wrong. In view of the poor rail service that still exists in the Northeast, following the

June 1999 split up of Conrail by CSX and Norfolk Southern, shippers and Congress could overreact."
Michael Lloyd, Merrill Lynch, Railroads: BNI/CNI Railroad Merger Hearings (Feb. 18, 2000).

"If UNP still feels it has to do something now in response to BNI/CNI, it may give serious consideration to asking Canadian Pacific about purchasing all or part of CP Rail."
Michael Lloyd, Merrill Lynch, Railroads: BNI/CNI Railroad Merger Hearings (Feb. 18, 2000).

Exhibit 1

February 16, 2000

THE JOURNAL OF COMMERCE Online

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Surface Reflections
Lawrence H Kaufman

Pssst! You want to buy a railroad? Cheap?

Railroad stock prices and market capitalization are in a depression not seen since the days before deregulation 20 years ago.

Without exception, investors have a one-sided view of railroads. As Jim Higgins, rail analyst at Donaldson, Lufkin & Jenrette Securities Corp., recently wrote to clients: " . . . stock prices over the last two weeks came in just two flavors: relatively weak for those that matched or exceeded earnings projections and relatively weaker for those that in any way disappointed."

How bad is it? Look at the two Eastern megasystems, CSX and Norfolk Southern.

CSX market capitalization at the weekend was $4.7 billion, and at $21.63 its stock was selling for less than half its 52-week high.

Norfolk Southern fared even worse. Its market capitalization of $5.57 billion is less than NS paid for its 58% of Conrail. At $14.625 a share, NS stock is down 60% from its 52-week high of $36.43.

Western and Canadian railroads did only slightly better. Burlington Northern Santa Fe Corp. has a market capitalization of $9.8 billion and at $21.44 a share, its stock is down "only" 43.5% from its $37.93 52-week high.

Would-be merger partner Canadian National Railway has a $4.87 billion market cap and its $25-a-share stock is down 31.7% from its 52-week high.

Union Pacific, the largest railroad in North America, has a total market value of $9.1 billion, and at $36.75 its stock is down 45% from its 52-week high.

Canadian Pacific and Kansas City Southern Industries look good by comparison. But CP is a conglomerate with oil and gas, pipeline and other businesses, and KCSI gets most of its profit from a lucrative money-management business that it is about to spin off to shareholders. CP stock is down only 26% and KCSI is holding value with an 8.6% decline.

The shrinkage in rail valuations is scary. Just think: If any of these new Internet billionaires were rail fans, they could buy a real railroad with chump change. Remember, dot-com guys have bought professional basketball teams just for the fun of it.

The thought of some bargain hunter buying a railroad may not be preposterous as it sounds. One group considered taking a run at Union Pacific because its market cap has fallen below $10 billion. NS could be bought for less than it paid for Conrail, and the buyer would have the entire railroad.

UP might be a better buy than NS because it is easily divisible into three to five parts that would have greater value than the whole. NS is more valuable as a whole, but the investment could not be recouped as quickly.

I interviewed Arnold McKinnon, former NS chairman, president and chief executive, in 1987, when his company was sitting on nearly $1 billion in cash and had a debt-to-equity ratio of only 14%. Many in Wall Street were advising McKinnon to "do a deal" before a raider came along and snatched his company.

The affable and courtly rail executive said he supposed a raider could buy the company and use its cash to pay down the debt.

"But we don't have a lot of other assets to strip," he said, "and when they're all done, they still would have to run the railroad, and no one runs it any better than we do."

I'll leave to the securities analysts the question of whether railroad stock prices are cheap or not. Clearly, they are low in comparison to recent periods.

That is bad, and here's where a Catch-22 begins, and it gets worse. Remember: In Catch-22, you could only avoid flying combat missions by claiming you were insane. But the mere fact of making such a claim to get out of combat proved you were sane.

Market capitalization affects a company's ability to raise additional capital. If a railroad wants to finance capital spending by borrowing, a low capitalization means it can't borrow as much before throwing its debt-equity ratio out of whack.

Correspondingly, with a high market cap, it can borrow more. If it sells new stock, a low capitalization means it can raise less money before diluting the current owners' interest. Raising new capital is easier with a high valuation.

Right now, Wall Street is telling railroads they have got to take steps to increase stock prices. About the only way to do that is by reducing capital spending to increase the cash flow investors are looking for. But that would affect the railroad's ability to provide customers with consistently better service.

What's a railroad executive to do? He can try to generate improved earnings by raising prices. But then he risks driving the customer to ship by truck or barge or some other alternative.

It is Catch-22. You're damned if you do, and you're damned if you don't.

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Exhibit 2

No Express Track for This Merger

By Louis Jacobson

LIZ LYNCH

Railroad Association's Edward Hamberger: His member's aren't united behind a proposed rail merger, but they all oppose new federal regulations.

Could trouble be lurking just around the bend for America's railroads? For nearly 20 years, the influential Association of American Railroads and the scores of outside lobbyists that it has hired have managed to fend off calls by the railroads' biggest customers—a coalition of utility companies, agribusiness operations, and chemical manufacturers—to impose more forceful federal oversight on the rail lines' pricing policies and competitive practices.

But the railroads' united front against stiffer federal regulation has faced an unusually stern test since December. That's when Burlington Northern Santa Fe Corp. and Canadian National Railway Co. proposed a landmark combination—a mega-merger that comes on the heels of Union Pacific's takeover of Southern Pacific in 1996 and the divvying up of Conrail between CSX and Norfolk Southern in 1999.

The spate of mergers has heightened complaints about poor service and dwindling competition. Although railroad shippers have raised such gripes for years, the latest proposed merger has prompted BNSF's remaining competitors—among them Canadian Pacific, CSX, Norfolk Southern, and Union Pacific—to raise some of the same issues themselves. They argue that the merger should be delayed because it will only prompt more customer complaints, especially about late deliveries.

"The reality is that the merger might cause shippers to go to elected officials and say, 'This is not right—we need someone to step in and slow this down,' " Gary F. Schuster, a Union Pacific spokesman, said in an interview. "In surveys of our own shippers, they tell us that they're concerned about this and will stand up about it in hearings."

CSX Chairman and CEO John W. Snow—whose line operates over a vast area east of the Mississippi River—has also worried aloud about how the merger could affect the industry's battle against proposed federal regulations. The merger "almost certainly will give opportunities for the re-regulation forces ... that they otherwise wouldn't have," Snow told an audience of Wall Street analysts in late January. "We were looking at 2000 as a year where there would be very little activity on the re-regulation front. Now the forces of re-regulation have gathered some momentum."

For the long-ignored rail-customer coalitions, the unexpected split among the railroads is a welcome development. The merger "draws the attention of Congress," said Robert G. Szabo, executive director and counsel for Consumers United for Rail Equity, whose members are mostly electrical utilities whose coal and machinery are hauled by rail. "Some members of Congress have always understood that there's a problem, but they never wanted to have to pick between the railroads and us, and even less so when labor gets thrown into the mix. But the merger has thrust the issue onto the policy agenda."

Although the $19 billion merger—which would create North America's largest railroad—cannot receive final approval from the federal Surface Transportation Board until mid-2001, the debate is already heating up. The board, which is the government's independent rail oversight and regulatory arm, plans hearings on March 8-9, and passions are expected to flare. "The two sides are scarfing up all the lobbyists" in preparation for the merger fight, a Capitol Hill aide said.

Caught in the middle is the Association of American Railroads. The association, whose effectiveness is widely lauded by Washington analysts, has been forced to remain neutral because its membership is split over the merger. Still, AAR President and CEO Edward R. Hamberger emphasized in an interview that his group is continuing to work overtime on its anti-regulatory agenda, which is considered crucial to the industry because additional regulations could (the association argues) put a crimp in profitability and infrastructure investment.

The merger dispute "hasn't changed things," Hamberger said. "Our members are still united [against regulations]. For our industry, it clearly is the No. 1, life-and-death issue."

Although the industry is still likely to beat back a push for any fresh restrictions, the emergence of the merger controversy has already begun to drain manpower and brainpower from the railroads' fight against regulation, officials said. At BNSF, "Our activity since Dec. 20 clearly has been focused on our combination with CN," rather than fighting shipper advocates, spokesman Richard A. Russack said. "Our energies have been put toward educating as many people as we can" about the merger, he stated.

The long-running battle between rail customers and the railroads boils down to key proposals involving changes that, according to the shippers, would promote competition but, in the railroads' view, would require too much federal interference.

"Rail customers across the board have been concerned about the increasing levels of consolidation, deterioration of service, and increasing costs," said Diane Duff, executive director of the Alliance for Rail Competition, which represents a broad coalition of shippers. "We want to focus on providing market-based solutions." If nothing is done, she said, "the endgame we're talking about is a two-railroad monopoly in North America. No other industry has been allowed to amass that kind of market power."

But railroad lobbyists argue that increasing regulations would, in effect, take the industry back to the pre-1980 days, when Washington had a greater role in setting freight rates. A stronger government hand, they say, would decrease profits and make it more difficult for the lines to invest in and maintain their infrastructure, from tracks to railcars. Neglected infrastructure, they say, would produce a critical decline in on-time operations—precisely when concern is growing about America's overcrowded highways.

"If the government gets in the business of greater control, we're going to have to shut lines," a CSX spokesman said. "If we're forced to give access to our competitors, then what incentive do we have to reinvest in our physical plant?"

AAR President Hamberger added that, since deregulation in 1980, shipping rates have fallen, and safety and productivity have improved. "This fight is about an effort to inject the government into private-sector activity with the goal of transferring money from one industry to another," he said.

Take My Hand; It'll be a Rough Ride: The proposed linking of Canadian National Railway and Burlington Northern Santa Fe is bursting boilers all over Washington.

Several members of Congress clearly don't buy his arguments. Virtually identical measures introduced in the Senate by John D. Rockefeller IV, D-W.Va., and in the House by Jack Quinn, R-N.Y., would implement many of the items on the shippers' wish lists. A separate measure sponsored by Rep. James L. Oberstar, D-Minn., also incorporates many of the shippers' proposals.

Rep. Jerrold Nadler, D-N.Y., has introduced a bill with a somewhat different focus that rail customers say they might support if certain changes are made. A Senate bill sponsored by Kay Bailey Hutchison, R-Texas, proposes a middle ground, but neither side appears to have warmed much to its proposals yet. About the only bill palatable to the railroads so far seems to be a measure sponsored by Senate Commerce, Science, and Transportation Committee Chairman—and presidential candidate—John McCain, R-Ariz. McCain's bill would reauthorize the Surface Transportation Board without significantly changing the board's authority to intervene on behalf of the railroads' customers.

Several players have taken the lead on behalf of shippers. Consumers United for Rail Equity, a group led by lobbyist Szabo of Van Ness Feldman, was founded in 1983. Its members include American Electric Power Co., Carolina Power & Light, Entergy, Ethyl Corp., FMC Corp., Kansas City Power & Light, and Potomac Electric Power Co. During the 1980s, the group helped fight for the shippers' agenda in Congress and, at one point, came within a few votes of victory. But within months, Szabo said, re-regulation was "in remission" until 1995.

By the mid-1990s, a succession of rail mergers had dramatically reduced the number of players in the railroad industry. Amid shipper concerns that the rail lines were becoming monopolistic, another shipper group emerged in 1997—the 60-member Alliance for Rail Competition, which some analysts paint as more aggressive than Szabo's group. Although some utilities belong to both groups, ARC boasts a more diversified roster of members, including such chemical giants as Dow Chemical Co. and DuPont, as well as major agricultural interests. The alliance has hired Ketchum Public Relations but has not retained any outside lobbyists, Executive Director Duff said. Meanwhile, several heavyweight trade associations have waded into the fight on their own.

Considering their combined clout, some observers are surprised at how little headway the shippers have made. "The railroads have really outfoxed these guys," said a former Capitol Hill aide who worked extensively on transportation issues. "Coalitions like that have got to be pretty damn frustrated."

Many transportation specialists—including those who work on behalf of the shippers—said the rail lines have prevailed because they have top-flight public-policy operations, both at the AAR and within the member railroads.

In July 1998, the AAR hired Hamberger, then an outside lobbyist for BNSF, to succeed M.B. Oglesby Jr. as president. Hamberger, 49, is a veteran politico who sports a résumé that in the world of transportation is basically gold-plated.

Before taking the rail association post, he had been head of the Washington office of Baker, Donelson, Bearman & Caldwell, the Tennessee-based law firm. Before that, Hamberger was assistant Transportation secretary for government affairs under President Reagan. Earlier in his career, Hamberger worked for Bud Shuster, R-Pa., now the powerful chairman of the House Transportation and Infrastructure Committee.

Hamberger took over AAR in the wake of a dramatic downsizing and reorganization that was largely undertaken to reflect the industry's changing economic structure. (The association includes all of the big cargo and passenger rail companies in the United States, Canada, and Mexico.) Although the association's interests range from safety testing to scheduling management, Hamberger says that his mission is to focus heavily on public policy.

His group has called on plenty of outside help. It retained nine different lobbying firms last year, according to the authoritative *Washington Representatives* directory, and recently hired ex-Rep. Susan Molinari, R-N.Y., to fight against new federal regulatory powers. In the meantime, the American Short Line and Regional Railroad Association's views mirror those of the AAR on each of the pending pieces of congressional legislation, said Alice C. Saylor, the group's vice president and general counsel.

The rail lines themselves are no slouches on the lobbying front. In addition to its five-person Washington office, CSX retained 14 lobbying firms last year, according to *Washington Representatives*, and it recently added Akin, Gump, Strauss, Hauer & Feld and Oldaker and Harris to the mix. Union Pacific hired nine firms to help out its seven-person Washington staff; late last year, it added former House doorkeeper James T. Molloy as an outside lobbyist. And BNSF operates a three-person office and retains several outside firms. In late January, BNSF hired lobbying giant Cassidy & Associates to push for the merger with CN.

Some rail customers are compromising with the carriers. Both the National Mining Association and the National Grain and Feed Association have signed agreements with AAR that will enable shippers and the railroads to resolve disputes without initiating a federal regulatory case. More often, though, frustration reigns. "We're running into real problems with the mergers," a shipper representative said. "We've found service to be abysmal. Actually, they'd have to improve before they reached abysmal."

A factor that could make a congressional agreement more difficult to reach, experts say, is an ongoing dispute over when and how companies can reassign unionized workers and facilities once a competitor is taken over in a merger. A Hill aide said that unless the railroads and the unions can resolve that issue on their own, the chance that Congress will soon pass any legislation backed by rail customers is unlikely. And if the status quo continues, it's generally agreed, the railroads will continue to get their way. ■

Exhibit 3

BEFORE THE
SURFACE TRANSPORTATION BOARD

Docket No. 41242

CENTRAL POWER & LIGHT COMPANY

v.

SOUTHERN PACIFIC TRANSPORTATION COMPANY

Docket No. 41295

PENNSYLVANIA POWER & LIGHT COMPANY

v.

CONSOLIDATED RAIL CORPORATION

Docket No. 41626

MIDAMERICAN ENERGY COMPANY

v.

UNION PACIFIC RAILROAD COMPANY AND
CHICAGO AND NORTH WESTERN RAILWAY COMPANY

COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

Of Counsel:

ROBERT W. BLANCHETTE
Association of American Railroads

RICHARD P. BRUENING
Kansas City Southern Railway Company

JAMES V. DOLAN
Union Pacific Railroad Company

P. MICHAEL GIFTOS
CSX Transportation, Inc.

JEFFREY R. MORELAND
Burlington Northern Santa Fe Corporation

JEAN PIERRE OUELLET
Canadian National Railway Company

MARCELLA W. SZEL
Canadian Pacific Railway Company

BRUCE B. WILSON
Consolidated Rail Corporation

WILLIAM C. WOOLDRIDGE
Norfolk Southern Railway Company

ARVID E. ROACH II
J. MICHAEL HEMMER
CAROLYN F. CORWIN
Covington & Burling
1201 Pennsylvania Avenue, N.W.
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(202) 662-5388

Attorneys for the Association of American Railroads

October 15, 1996

VERIFIED STATEMENT

OF

ROBERT D. KREBS

I am Robert D. Krebs, President and Chief Executive Officer of Burlington Northern Santa Fe Corporation ("BNSF"), 2650 Lou Menk Drive, Fort Worth, Texas. I have held these positions since September 1995, when BNSF was created pursuant to the Interstate Commerce Commission's authorization of the common control of Burlington Northern Inc. and Santa Fe Pacific Corporation and their wholly-owned railroad subsidiaries. In this statement I will use the acronym BNSF to refer both to the parent corporation and to our commonly controlled and operated railroad subsidiaries, Burlington Northern Railroad Company and The Atchison, Topeka and Santa Fe Railway Company.

I began my career in the railroad industry with the Southern Pacific Company in 1966 following my receipt of a Master's Degree from the Harvard Graduate School of Business. I held various positions with Southern Pacific Transportation Company ("SPT") from 1966 until July 1982, when I was elected President of SPT. From December 1983 until July 1987, I was President and Chief Operating Officer of Santa Fe Pacific Corporation ("SFP"). I became Chief Executive Officer of SFP on July 28, 1987 and was elected Chairman of SFP on May 24, 1988. I served as CEO and Chairman of SFP until I assumed my present position with BNSF last year.

I am submitting this statement in response to the Surface Transportation Board's request for comments in what is referred to as the "bottleneck" coal shipper proceeding currently pending before the Board. I understand that in this proceeding the Board is considering fundamental changes regarding the regulation of rates, and possibly the routing of traffic, on rail movements to or from facilities served by a single bottleneck rail carrier. If adopted, such a re-regulatory initiative would have a major adverse impact on railroad revenues and our ability to provide the best possible service to our customers. I urge the Board not to take any steps that would stifle the railroad industry's willingness and ability to make the new investments necessary to serve our existing shippers and to attract additional traffic.

I see grave risks for railroads, shippers and our national transportation system in the re-regulatory measures that the Board is considering. The risks are vivid to me because I spent the first 15 years of my career in an industry that was in decline, due in part to the heavy burdens of regulation. When I joined Southern Pacific in 1966, prospects for the industry were not bright. Railroads had been losing market share to trucks for years because rail rates were not competitive and service was poor. Track and equipment maintenance was slipping. Customers were not getting the reliable service they needed. Reinvestment in the nation's rail infrastructure was negligible.

The vicious cycle of declining revenues, under-investment, insufficient maintenance and poor service drove many railroads out of business. Nearly one-third of the 76 Class I railroads that existed in 1966 went into bankruptcy during my first 15 years in the business, including such well known names as the Penn Central, the Rock Island and the Milwaukee Road.

The regulatory reforms of the Staggers Rail Act of 1980 established a legal framework in which railroads had an opportunity to show their mettle. The new freedom to set prices in response to market demand gave us the incentive to cut costs and achieve efficiencies so that railroads could actually compete in the market. Our ability to offer lower rates and to provide better service enabled us to attract more customers. The numbers tell a story of remarkable efficiency gains in our industry since 1980:

- Employee productivity increased more than threefold, with revenue ton-miles per employee growing to nearly 7 million tons per year from 2 million;

- Revenue ton-miles per mile of railroad operated doubled from 5.2 million to 10.4 million;

- Asset productivity improved, as freight car and locomotive fleets have been reduced by 48% and 36% respectively;

- Fuel efficiency increased to 375 revenue ton miles per gallon from 235.

These efficiency gains have paid off for our customers. Rail rates have declined over 50% in constant dollars since 1981.

Virtually every shipper has benefited from rail rate reductions whether or not it is served exclusively by one rail carrier. But the Board must understand that not every shipper can or should pay the same rates. The economic realities of our industry require a mix of prices if railroads are to sustain themselves. There are four basic points:

- Because the railroad industry has very high fixed costs (the costs of track, roadbed, rolling stock, etc.), the cost of handling an incremental unit of traffic is lower than the average cost of handling all traffic on the system.

- It makes sense for railroads to compete for additional traffic, even if that traffic does not cover the system average costs, as long as it makes some contribution to fixed costs.

- But because some traffic is priced below average costs, there must be other traffic that is priced above average costs if we are to cover all our fixed costs.

- If railroads cannot cover their fixed costs, they cannot justify investments in new plant and equipment; in fact, the financial markets will discourage them from making such investments by driving up their cost of capital.

The success we had on Santa Fe during the 1980's and early 1990's was based on these economic realities. Santa Fe gained a reputation as a premier intermodal carrier during this time period, and we are proud of that reputation. To achieve a foothold in the intermodal business we had to cut costs and to make strategic investments. We could not have made the investments that allowed Santa Fe to compete effectively with trucks without the revenues from our other commodity groups, including such bulk commodities as coal and grain, and other traffic such as chemicals and general merchandise. It was the combination of cost reductions and the ability to price our services differentially that allowed us to make progress toward covering all of Santa Fe's fixed costs.

Now we are confronting a similar challenge on a larger scale at BNSF. As I testified in our merger application, one of the factors that made a merger between Burlington Northern and Santa Fe attractive was the prospect of the diversified traffic base of the two carriers moving over the combined BNSF rail system. Specifically, we contemplated that Santa Fe's strength in intermodal traffic would balance BN's traditional strength in coal and grain. Beyond this, the other principal benefits that we saw in the combination of BN and Santa Fe were the creation of extensive new single-line routes with expanded geographic coverage and substantial cost savings from combining the staffs and facilities of our two companies.

Realizing the benefits of our merger requires major capital investments. BNSF is investing in improved customer service. We estimate capital spending of $2.2 billion in 1996. About $1.3 billion is for maintenance of our infrastructure -- 3 million ties, 500 miles of new rail, 12,000 miles resurfaced. The additional $900 million is predominantly for expansion. Major projects include reopening Stampede Pass in eastern Washington to increase our capacity for intermodal, grain and general merchandise across the northern corridor. We are expending large sums to expand our intermodal facilities, including the Hobart Yard near Los Angeles, where we anticipate that our capacity to handle port-related traffic will grow to one million lifts per year. BNSF will take delivery of 220 new locomotives in 1996, over half of which will be additions to the fleet.

At BNSF, we are also striving to become a safer railroad. Our 1996 goal is to reduce the injury rate an additional 25 percent below historic levels. Through August, injuries were down 36 percent, while the number of lost work days was down 35 percent against our goal of 25 percent. We are not only focused on reducing personal injuries but also on reducing derailments and generally creating an era of safer train operations. We hope to be able to identify technologies like Positive Train Separation and electronic brakes that will help us avoid severe derailments and collisions. Of course, it will require more capital investment to put such types of technologies in place.

The point is that railroads like BNSF require continuous infusions of capital if they are to fulfill their potential to serve shippers and benefit the consuming public. We cannot justify the necessary capital investments, and indeed our Board of Directors would not approve such investments, unless we are confident that we will earn an adequate return on the capital employed in the business. And, for all my optimism about the future, I must remind the Board that such adequate returns have not yet been realized on an overall basis, either for BNSF or for the industry as a whole. Inadequate returns not only deter investment, they also make it more expensive to obtain funds from the capital markets.

This brings me to the "bottleneck" proceeding and the possibly severe adverse consequences that it could have on the rejuvenation and growth of the railroad industry that I have been describing. Requiring railroads to route traffic to interline carriers over nearby junctions at a shipper's request is contrary to the very concept of efficient, single-line service that our merger was designed to achieve. Of course we are anxious to implement operating improvements that serve our customers' business needs, but it is hard to imagine how inserting a new junction in an efficient rail movement could benefit anyone. On the contrary, the unnecessary interchange of traffic between two carriers results in nothing but increased costs for railroads and shippers -- both the costs resulting from delays and the costs involved in investments in facilities (such as sidings) necessary to accomplish the interchange.

The driving force behind railroad mergers has been to increase efficiency by providing more single-line routes and less balkanization. Therefore, I cannot believe that the Board (or shippers for that matter) seriously contemplate a regulatory change that would lead to a re-balkanized rail system. The demand that carriers establish junction-point rates is more likely a device to achieve rate reductions at the expense of the carriers who now serve shipper facilities. Viewed in this light, both the shippers' proposal and the Board's "intermediate approach" appear to be versions of more stringent rate regulation. The effect of either proposal would be to reduce rates on a significant portion of our traffic that involves "bottleneck" movements and to make a major dent in BNSF's revenues.

It is hard to overstate the adverse effects that would result from a significant reduction of our income through more extensive and stringent rate regulation. Although we have made progress toward earning our cost of capital, we are not there yet. Placing a regulatory cap on our revenues would be akin to requiring us to shift into reverse. The first causality would be capital investment. We would not be able to make all the capital investments necessary to maintain our system and to expand our capacity. Some attractive business that we could have won by upgrading our system would be forsaken. The lost contribution would make it harder than before to earn adequate revenues.

The reduced prospects for future earnings would obviously hamper our ability to raise capital for future projects by making that capital more expensive. The investor confidence that we have earned through the cost reductions and efficiency gains of the past 15 years would be shaken by the perception of an externally imposed revenue cap.

Second only to the adverse impacts of lost revenues is the dismal prospect of trying to run a business and raise capital under a cloud of regulatory uncertainty. To plan effectively for the future, we need to know what regulatory environment we are operating in. The prospect of multiple rate proceedings with uncertain outcomes before the Surface Transportation Board would severely disrupt our ability to implement our business plans. How can a railroad plan effectively for capital expansion when the revenues might or might not be forthcoming? The adverse effects of a regime of re-regulation would be compounded by the uncertainty of the investment community regarding our prospects for the future.

I am unaware of any evidence that there is a need for the re-regulatory measures that the Board has under consideration. The Board's decision calling for comments in the "bottleneck" proceeding stressed the Board's obligation to maintain a balance between the interests of carriers and the interests of shippers. But there is no indication that anything has become unbalanced. The fact that a handful of coal shippers see an opportunity to improve their positions in the short term should not be taken as a sign that the Board's existing role needs to be redefined.

The fact is that the overwhelming majority of shippers on BNSF, including shippers who are solely served by us, have seen their rates reduced significantly in real dollar terms over the last 15 years. These rate reductions reflect both the efficiency gains that we have achieved and the competitive options that our shippers use as leverage in rate negotiations. And virtually every shipper has competitive options, including our coal fired utility customers.

Far from seeking to exploit our customers, our goal is to make them more competitive in their businesses so they will have additional, profitable traffic to bring to our railroad. The way we can do this is to improve our service to our customers. And one thing we need to do to improve our service is to continue to invest in our rail network. There is nothing balanced about a regulatory scheme that would deter our ability to make investments to better serve our customers.

At BNSF we are committed to realizing the potential of this great industry that has struggled back to its feet and is now striding forward. I urge the Board not to shackle our progress.

VERIFICATION

STATE OF TEXAS)
)
COUNTY OF TARRANT)

Robert D. Krebs, being duly sworn, deposes and says that he has read the foregoing statement, knows the facts asserted therein, and that the same are true as stated.

Robert D. Krebs

SUBSCRIBED AND SWORN TO before me this 11th day of October, 1996

BARBARA R. TURNER
Notary Public
STATE OF TEXAS
My Comm. Exp. 11/30/99

Barbara R. Turner
Notary Public

My Commission Expires:
11/30/99

Exhibit 4

EXECUTION COPY

COMBINATION AGREEMENT

by and among

CANADIAN NATIONAL RAILWAY COMPANY

BURLINGTON NORTHERN SANTA FE CORPORATION

NORTH AMERICAN RAILWAYS, INC.

and

WESTERN MERGER SUB, INC.

Dated as of December 18, 1999

4812062

employee of CN providing for protections or benefits to such employee in the event comparable circumstances are satisfied; and

(g) from the date hereof until the Arrangement Effective Time, Newco shall not engage in any activities other than in connection with or as contemplated by this Agreement.

5.12 Implementation Committee. Immediately after the date of this Agreement, BNSF and CN will establish a committee (the "Implementation Committee") consisting of three representatives of BNSF and two representatives of CN. The initial BNSF representatives shall be Robert D. Krebs, Thomas N. Hund and Matthew K. Rose and the initial CN representatives shall be E. Hunter Harrison and Paul M. Tellier. The successor to any representative on the Implementation Committee shall be designated by the party that designated such representative. Without in any way limiting their rights under Article VIII or Article IX, BNSF and CN agree that the Implementation Committee shall be responsible, on behalf of both parties, for directing the preparation and presentation to the STB of all filings and other presentations in connection with seeking any STB approval, exemption or other authorization necessary to consummate the transactions contemplated by this Agreement, the prosecution of such filings and other presentation and negotiation (with the STB or any third party) of any matters in connection with seeking such approval. In addition to the foregoing, to the extent permitted by applicable Law, the Implementation Committee shall work actively to develop plans for the integration of the operations of CN and BNSF after the Arrangement Effective Time. BNSF and CN agree that the principal objectives of the Implementation Committee are to ensure that the STB approval of the transactions contemplated by this Agreement is obtained as expeditiously and on terms as favorable to Newco, BNSF, CN and their respective Subsidiaries as is reasonably possible, and to develop plans for the integration of the operations of BNSF and CN that will permit the most expeditious and favorable integration of such operations as is reasonably possible. The Implementation Committee shall act by consensus and not by majority vote of its members. The composition of the Implementation Committee reflects the nature of the issues to be addressed by the Implementation Committee with respect to CN and BNSF, and the fact that the STB process will relate to issues in the United States rather than to the relative influence of CN and BNSF on the Implementation Committee.

5.13 Interline Coordinations. As soon as practicable after the date of this Agreement, BNSF and CN shall, to the extent consistent with applicable Law, work in good faith to develop and implement a range of mutually beneficial interline coordinations. Without limiting the generality of the foregoing, it is currently contemplated that such interline coordinations will include, among other things, to the extent consistent with applicable Law, matters relating to information technology (intended to develop a common information technology platform), procurement and marketing.

5.14 Dividends. CN and BNSF shall coordinate the declaration, setting of record dates and payment dates of dividends on CN and BNSF common stock so that (i) holders of CN common stock do not receive dividends on both CN Common Shares, on the one hand, and Newco Common Shares or CN Exchangeable Shares received in the Arrangement, on the other hand, in respect of any

Exhibit 5

Government of Canada Gouvernement du Canada

Merger Review under the *Competition Act*

February 2000

[redacted]

COMPETITION BUREAU

Merger Review - Analytical Framework

- Efficiencies
  - If conclude that merger results in anticompetitive effects(i.e. a substantial lessening or prevention of competition), the parties may argue the efficiency exception
  - S. 96 provides a "defense " when efficiencies are greater than and offset the anticompetitive effect
  - Consider only efficiencies that directly arise from merger and could not be achieved without merger

COMPETITION BUREAU

Exhibit 6

Merger Concerns Misplaced

In his letter to *Traffic World* in the Jan. 17 issue, Terry Whiteside writes, "The Union Pacific has already been identified as being susceptible to some of the most serious traffic diversions that would result from the proposed combination of Canadian National and Burlington Northern Santa Fe." Precisely. Faced with the prospect of heightened competition, UP would have no choice but to improve its service offerings, a development that will benefit shippers. Incredibly, Mr. Whiteside suggests that UP must be protected from competition.

Mr. Whiteside's worry that UP would "simply go out of business" is one of many misplaced concerns in his letter.

Mr. Whiteside describes the end-to-end CN-BNSF combination as a "side-by-side" merger that will eliminate competition and create captive shippers. He is greatly mistaken. Our preliminary figures show that our combination will result in only a handful of shippers — shippers generating one-third of 1 percent of the revenues of a combined CN-BNSF — facing the potential loss of service from a second railroad. Ensuring continuation of rail competition at those points will be fully addressed in the upcoming Surface Transportation Board proceeding.

Mr. Whiteside postulates that a CN-BNSF combination will reduce customer choice and offers, as an example, an alleged reduction in shipping choices for Midwest corn growers. To the contrary, the combination will make it possible for BNSF shippers to access the center Gulf ports served by CN, enable CN shippers to access more easily Texas ports and Mexican gateways, and in the case of CN shippers in Iowa and Illinois, will open up access to U.S. West Coast ports. In addition, corn shippers benefit from the availability of a larger covered hopper fleet as CN and BNSF take advantage of the varying seasonality between their two systems. Mr. Whiteside's fear that shippers will lose access to the Mississippi River runs counter to the lengthy experience of shippers with the former Illinois Central, which is now part of CN. For years, that railroad, paralleling the Mississippi, thrived by carrying corn to processors, to the river as part of rail-barge moves, or all the way to the Gulf. All those choices are available to shippers today and will be augmented with new choices following the combination of CN and BNSF.

Mr. Whiteside raises the fear that a CN-BNSF combination will visit upon shippers the horrors they endured in the wake of the UP-Southern Pacific merger and the carve-up of Conrail. He refuses to acknowledge that the merger of CN and IC has been accomplished without a single hiccup.

Mr. Whiteside raises the fear that a CN-BNSF combination will visit upon shippers the horrors they endured in the wake of the UP-Southern Pacific merger and the carve-up of Conrail. He refuses to acknowledge that the merger of CN and IC has been accomplished without a single hiccup. Unlike the UP-SP merger, which included at least one railroad suffering from underinvestment, the combination of CN and BNSF will unite two financially healthy and well-maintained systems. A CN-BNSF combination, yes, by its end-to-end nature, will be far simpler than the merger of UP-SP or the partition of Conrail. Unlike past mergers, BNSF and CN will actually continue as separate entities, preserving existing working relationships with shippers. A new entity, North American Railways, will direct coordination of rail service to be provided by the common enterprise to ensure that shippers benefit from the far-reaching single-line service made possible by the combination.

Perhaps most important, Mr. Whiteside ignores the fact that at the very same time UP, NS and CSX were burdening their shippers with service failures, CN and BNSF were substantially improving both on-time service and transit times.

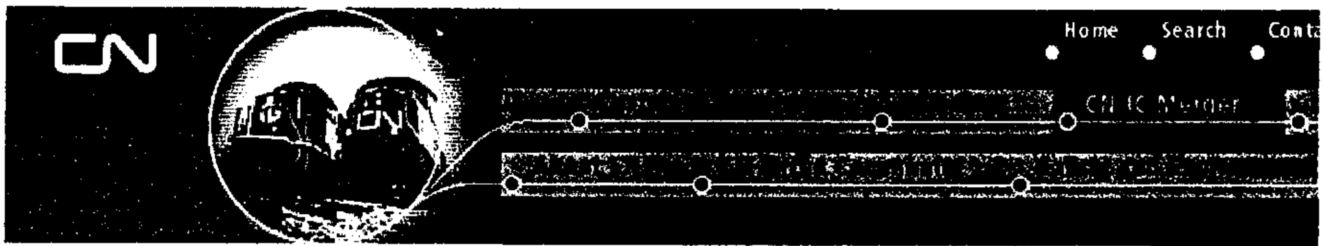
The combination of CN and BNSF offers considerable opportunities to make even greater improvements in service. A CN-BNSF combination will mark only the second time — the CN-IC merger was the first — that railroads operating on opposite sides of Chicago have linked up. A CN-BNSF combination presents numerous opportunities to route traffic around Chicago, the biggest and frequently most congested rail gateway.

While Mr. Whiteside insists upon flavoring the CN-BNSF combination with the bad taste left by the UP-SP and the Conrail-CSX-NS deals, he ignores yet other differences between this and earlier transactions. The CN-BNSF combination, since it will be achieved through an exchange of stock, will not be burdened with the new debt that management will be under pressure to repay. CN and BNSF have also made it clear that two operating companies, two cultures and the people who work in those companies and cultures will be maintained, so the CN-BNSF combination will not suffer the drain in institutional and professional knowledge that has followed other transactions.

Traffic World correctly predicted in its Jan. 3 editorial that competing railroads, fearing heightened competition, would attempt to parlay the shipper unrest they had created into opposition to the BNSF-CN combination. With all due respect for Mr. Whiteside, when shippers weigh all the evidence, they are already beginning to see through this anti-competitive and self-serving smokescreen of UP, NS and CSX. Shippers are already starting to see how the BNSF-CN combination will benefit them in a myriad of ways, not the least of which will be producing solutions to problems created by other railroads.

JAMES M. FOOTE, SENIOR VP
SALES AND MARKETING
CANADIAN NATIONAL RAILWAY

Exhibit 7



Integrating CN and IC

FAQ

- Update
- FAQs
- Delivering on the merger promise
- Shippers Satisfaction
- Map
- Computer Systems Integration
- STB Written Decision

Did You Know ?

The newly merged CN is the only truly North American railroad, serving the continent from the Atlantic to the Pacific to the Gulf of Mexico. No other railroad can give customers that kind of reach.

What does the merger mean for shippers?

The merger provides shippers with more competitive options to extend their market reach. The new CN extends from the Atlantic to the Pacific and down to the Gulf of Mexico, creating the only true North American railroad on the continent. Shippers now have direct access to more markets, more gateways, and more efficient service through Chicago.

What happens next during implementation?

Bringing CN and IC together is no simple exercise. It takes careful planning, extensive coordination, and a lot of hard work. Integrating the two companies will take place over two to three years and will be a methodical, step-by-step process.

On July 1, 1999, both railroads gradually start to integrate operations. Marketing is selling a single-line service with more efficient routes through and around Chicago.

One of the most significant steps the new railroad can take to realize the full benefit of the merger is to integrate CN and IC information technology systems. The schedule for systems integration is conservative and staged to minimize impact on customers.

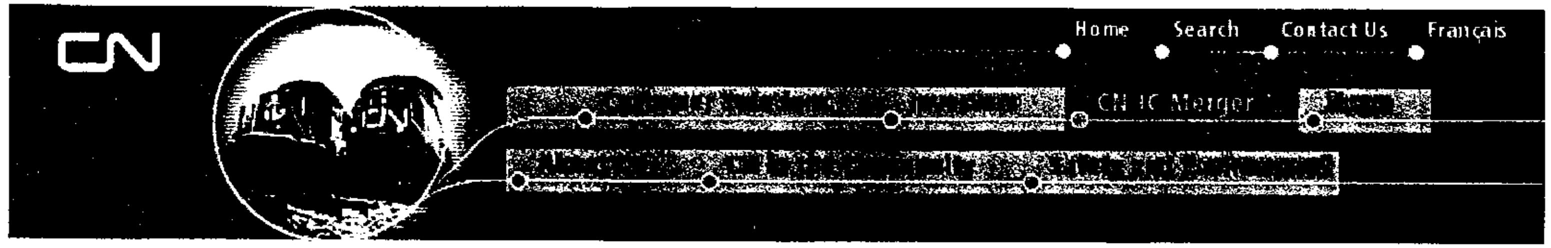
What steps is CN taking to ensure its safety performance remains strong?

CN is a leader in safety in North America, and safety is a core value at both CN and IC. There will be no artificial deadline for completing the integration of CN and IC. Our actions will be based on two overriding concerns: safety and service.

Our safety integration plan, which has already been approved by the Federal Railroad Administration, will form the basis of the integration of our safety programs. We will continue to focus on safety with such programs as high incident safety procedures, effective health and safety training, and performance monitoring, plus we will continue our commitment to the Responsible Care initiative.

HOME PAGE UP

Exhibit 8



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Integrating CN and IC

Computer Systems Integration

- Update
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Integrating Computer Systems: The Key To A Successful Merger

CN is approaching this issue very deliberately through the gradual introduction of its Service Reliability Strategy (SRS).

SRS is a set of advanced computer programs that tracks each car or intermodal unit as a separate shipment. It is an integrated data base system that allows employees across the railroad to work from the same information to manage traffic, build trains and measure performance.

The advanced SRS system is scheduled to replace IC's existing TCS system in the fall of 2000. This provides CN the time it will take to ensure that all IC employees are trained and ready to use the tool. Employees who will use SRS can already look at the system on their computers. In May 2000, they will be able to practice their job responsibilities using SRS in a "virtual environment" that simulates actual traffic movement and waybilling.

SRS is a Set of Databases that Links Six Components

Waybill

- Relates all car events to a customer or product

- When a car is released, SRS "demands" a waybill for the shipment

Service Scheduling

- Each car or container has a trip plan from origin to destination
- SRS determines train connections (including empties)
- Monitors car movement and notifies traffic controllers when a shipment is in jeopardy

Yard Operating Plan

- Defines routine tasks in yards and identifies resources
- Links traffic coordinator, shops, crew centers and engineering

Train Movements

- Records car movement and building of trains within a yard and between stations
- Records arrivals and departures of trains
- Industry functions include car placements, ordering and release of cars, customer destination instructions and notification of arrivals
- Manages demurrage and miscellaneous freight bills

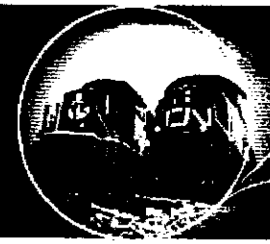
Intermodal

- Records arrivals and departures of trailers and containers
- Assigns position and equipment to move the unit on and off trains

Revenue Management

- Automated business application for waybill control and accounts receivable

Exhibit 9



CN

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Integrating CN and IC

Delivering on the merger promise

- Update
- FAQs
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Service

Comparing year-to-date 1999 versus 1998 CN/IC has achieved the following improvements

- 18% reduction in yard dwell time
- 16% increase in cars handled per yard switching hour
- 8% increase in car miles per car day -- a measure of the velocity of cars on the network

Trip Time Improvement

- 4.7 day improvement - CN - Chicago - Laredo, TX
- 3.5 day improvement - CN - Chicago - Jackson, MS
- 3 day improvement - Flint - Chicago - St. Louis, MO

Investment

In its STB filing, CN committed to invest $141.5 million over and above normal capital expenditures in the first three years of the merger. In the first five months of the merger

CN/IC is well on its way to meeting that commitment.

- Yard improvements – $14.1 million spent and $7 million in the planning stage
- Intermodal and Automotive Facilities – $20 million awaiting finalizing land acquisitons and customer agreements
- Information Technology -- $8.2 million spent on systems integration and $18.4 million planned for 2000
- Locomotives – $4.2 million spent for additional locomotives to handle incremental traffic

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Exhibit 10

'Full Picture' of CN Service

John Gallagher's article Canadian Service (June 28) is unbecoming of a trade periodical such as *Traffic World*. Mr. Gallagher made sweeping judgments about Canadian National's service performance and operating practices — not on the strength of thorough analysis, but on the basis of an unknown number of claims from anonymous sources. This is not fair, balanced journalism.

Specifically, CN was given no detailed information by Mr. Gallagher about the claims of a "western chemical shipper" and thus had no opportunity to examine and respond to them in full. What's more, Mr. Gallagher at no time spoke to CN about a claim that CN holds trains "until (they) are full" — the claim is inaccurate — or CN' s transit times for coal shipments.

Here's the full picture on CN's service performance:

- CN's comprehensive service plan – a conveyor-belt-like schedule of train services implemented last fall — has significantly improved transit times for shippers and reduced the amount of time freight cars dwell in yards. CN is so confident of its service plan that it quotes transit times to customers in hours, not days.
- CN does not hold trains to fill out tonnage or "until trains are full" – trains depart terminals on schedule, regardless of the tonnage on hand.
- CN's service plan, on average, has reduced dock-to-dock transit times by 24 hours. Dwell time for freight cars in yards is on average 21 hours, versus 30 hours before the plan was implemented.
- CN's dock-to-dock on-time performance for merchandise traffic in the past month was 79 percent and 90 percent within 24 hours. This is unprecedented in North American railroading.
- On-time performance for intermodal trains during the second quarter reached record levels.
- Trip-plan compliance for chemical traffic has improved consistently in recent months.
- CN shares trip-plan compliance data with its shippers.
- CN has not slowed its coal trains; these trains are scheduled in cooperation with shippers and port authorities to achieve "direct hits" at export ocean terminals. In June, some coal trains experienced delays on account of two main line outages in western Canada owing to high spring water run-off in the Rocky Mountains.
- CN's customer service logs regarding service issues are at an all-time low.

CN is totally committed to its service plan. It's producing tangible benefits for shippers and has enabled CN to make more effective use of its assets by turning them more quickly. CN's numbers prove it.

MARK HALLMAN
SYSTEM DIRECTOR,
MEDIA RELATIONS
CANADIAN NATIONAL RAILWAY CO.

Buying What He Needs

In response to the recent "Unconvinced" individual regarding Roadway's Guaranteed Day Delivery Service (and the fact that they charge for it), I need help understanding why there is an issue here.

Carriers have long provided services that "added value" to normal point-A-to-point-B transportation, generally without additional cost to the transportation purchasing public.

A wise marketing group recognized the dollar value of this service and began charging accordingly. Finally, rather than trying to convince me, as a traffic manager, that I need all these value-added services and should take substantial increases to support their existence, I can pick and choose what I want, when I want it. Consequently, my base rates remain relatively low. I find this a refreshing alternative to increased rates as a result of some "value addition" overture by the carrier.

No secret here — transportation is still a bargain relative to other manufacturing and distribution costs, and if I can purchase point-to-point transportation without the frills and not see significant increases, I'm a happy transportation consumer. If I need it, though, it's nice to know it's there. I don't buy fancy running shoes with reflective tape if I'm just walking during the day. But it's nice to know they're available should I change exercise habits.

BOB LEDFORD
MANAGER, CORPORATE
TRANSPORTATION
CCP
KANSAS CITY, MO.

Exhibit 11

5/8/95

On-Time Performance Hits Record at Santa Fe

SCHAUMBURG, Ill. — Atchison, Topeka and Santa Fe Railway Co. said its systemwide April on-time performance reached a record of 94%.

The company said 96% of its intermodal trains, which carry roughly half of the railroad's shipments, had arrived at the time agreed upon with customers.

April results were a slight improvement over the first quarter of 1995, when overall on-time service levels were 92%.

Over the first four months, unit trains of bulk freight had a 98% on-time performance record, Santa Fe said.

Exhibit 12

Record ID # 994

Previous Next Index

BNSF, UP Sign Historic Dispatching Agreement

02/08/99

Railroads to Create Coordinated Dispatching Operations Covering Southern California, Kansas City and Powder River Basin of Wyoming

OMAHA, Neb., and FORT WORTH, Texas, February 8, 1999 -- Union Pacific Railroad (NYSE:UNP) and The Burlington Northern and Santa Fe Railway Company (NYSE:BNI) today announced they have agreed to coordinated dispatching operations covering Southern California, the Kansas City area and the coal-rich Powder River Basin of Wyoming. It is the largest railroad coordinated dispatching agreement in history.

The goal of the new agreement, announced jointly by UP chairman and CEO Dick Davidson and BNSF chairman, president and CEO Robert Krebs, is to improve rail service in three of the country's busiest rail centers. The agreement is patterned after a successful dispatching arrangement in Spring, Texas, covering the Houston and Gulf Coast areas.

"The spectacular success of our joint dispatching center in Spring, Texas, has greatly improved train operations in the Texas Gulf Coast region," said Dennis Duffy, Union Pacific executive vice president operations. "It is clear we can use the same approach to overcome difficult operating issues in other areas of the country which have similar unique strategic circumstances."

"The improvements we have seen as a result of the Spring center confirm our belief that in regions where two or more railroads share track and the efficiency of their operations are dependent upon each other, improved cooperation and communication in the dispatching process are keys to enhancing the level of service our customers expect," said Matt Rose, BNSF senior vice president and chief operations officer.

Specifically, the agreement will establish coordinated dispatching centers in San Bernardino, Calif., and Kansas City, Mo., while UP dispatchers supporting the UP line from North Platte, Neb., into the Powder River Basin of Wyoming will join BNSF dispatchers at BNSF's Network Operations Center in Fort Worth, Texas. Union Pacific's centralized train dispatchers are located in the Harriman Dispatching Center in Omaha.

Other railroads, both commuter and freight, operating within the territories that will be dispatched by these new centers will be extended an invitation to participate in the coordinated operations.

The San Bernardino center, scheduled to be launched in May, will coordinate UP and BNSF train operations in the Los Angeles area as well as the historic Cajon Pass and Tehachapi mountain passes in California. BNSF currently dispatches trains over Cajon Pass, which provides access to Southern California from the east. Tehachapi Pass between Mojave and Bakersfield, a key north-south route, is controlled by UP with BNSF trains running on trackage rights. The UP agreement to use Cajon Pass began in 1905 and the Tehachapi line was opened to BNSF predecessor Santa Fe in 1899.

The Kansas City dispatching center, which will be housed at BNSF's Argentine Yard in Kansas City, Kan., and is expected to be operational during the third quarter of 1999, will control train traffic in the nation's second busiest rail center with lines from BNSF, UP and other railroads converging from all points of the country. Both BNSF and UP have major switching yards in the Kansas City area.

Wyoming's Powder River Basin is the nation's largest source of low-sulfur coal. The two railroads began sharing trackage in the basin in 1984. BNSF controls the "joint line" access to the basin from the south, which is also used by UP. Record amounts of capital have been spent in recent years to add track capacity on the busy line. It is expected the new agreement will help both railroads meet anticipated growth demands. UP, which has already begun to add personnel in the Fort Worth center in connection with Powder River Basin operations, expects to expand its presence there within the next two weeks.

The Spring center, opened in March 1998, controls UP and BNSF trains between Houston and New Orleans over more than 340 miles of track, as well as track in the Houston area. Supervised by a neutral officer, the facility includes a consolidated UP/BNSF operation where dispatchers from each railroad control their respective lines along the entire Gulf Coast region.

By almost any measure, the dispatching center in Spring has been a success. For example, blocked sidings between Houston and New Orleans were reduced from a daily average of six to zero within the first 60 days of the center's opening, leading to increased velocity and improved schedule adherence. Trains going "dead on the law," meaning those whose crews have reached the maximum number of continuous hours worked under the federal Hours of Service Act and, therefore, must stop until the crews are relieved, have been drastically reduced from a high of 64 per month in May of 1998 to a total of 15 in January 1999, further signaling an improvement in velocity.

Union Pacific Railroad, an operating subsidiary of Union Pacific Corporation, is the largest railroad in North America, operating in the western two-thirds of the United States. The 36,000-mile system serves 23 states, linking every major West Coast and Gulf Coast port..

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